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C O N F I D E N T I A L SECTION 01 OF 03 BAGHDAD 002632

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SUBJECT: MINISTER OF OIL OPTIMISTIC ABOUT IRAQ'S OIL FUTURE

Classified By: DCMAT PHaslach for reasons 1.5 b,d

¶1. (C) Summary: In a September 17 meeting with Deputy Secretary James Steinberg, GOI Minister of Oil Hussayn Shahrستاني expressed optimism about the upcoming second oil licensing round, as well as for Iraq's future willingness to sign a gas agreement with Europe. In the wide ranging discussion, Shahrستاني also touched on a possible third licensing round, the fate of the first round fields that were not awarded, oil sector reform legislation, and natural gas development in Iraq. End Summary.

¶2. (C) GOI Minister of Oil Hussayn Shahrستاني, accompanied by Deputy Minister (Downstream) Mo'tasam Akram Hassan, met on September 17 with a U.S. delegation led by Deputy Secretary of State James Steinberg that included DCMAT Patricia Haslach, Economic Minister Counselor John Desrocher, Senior Advisor for Iraq and Regional Issues Elissa Slotkin, and Econoff (notetaker). Shahrستاني was in good spirits throughout, and engaged openly in a wide range of topics raised by the Deputy Secretary.

Bid Rounds

¶3. (C) Shahrستاني was upbeat about the trajectory of recent events in Iraq, noting approvingly that the USG and GOI have worked closely together in "largely expelling Al Qaeda in Iraq," though he admitted Mosul remained a hot spot. He also took a moment to offer condolences on the eight personnel (TCN construction workers) that had been severely wounded the night before in a rocket attack on the Embassy. Turning from security to oil, he said Iraqi oil production had recently exceeded 2.5 million barrels per day, with just over 2.0 million barrels per day average exports. He admitted he'd hoped that the first oil licensing round (held in June) would have yielded more contracts, but even the one field awarded will eventually increase Iraq's oil production to over 4.0 million barrels per day. (Note: The only field awarded in that bid round was the super-giant Rumaila oil field, one of the largest oil fields in the world.) Shahrستاني is optimistic that the second licensing round will produce more contracts, now that the Ministry and the International Oil Companies (IOCs) are "learning how to deal with one another."

By his estimation, thanks to the results of the first bid round and the expected results of the second, Iraqi oil production could exceed 6.0 million barrels per day in just six to seven years. He said the GOI is considering a third licensing round that would offer only exploration blocks (whereas both the first and second rounds focused on known fields). An announcement of this third round could come as soon as late 2009.

The BP/CNPC Negotiation

14. (C) Asked what lessons he had learned from the first bid round, Shahrستاني did not raise the bid round mechanics (and its much scorned maximum remuneration fee structure), but focused instead on what the Ministry is learning from its negotiations with British Petroleum (BP, winner of the contract to work on the Rumaila field). The deal with BP is almost completed, he said. While there was "a need for some rewording" of the contract, "there will be no change to the economics." Both BP and consortium partner CNPC are "happy with" the USD two dollar per barrel fee structure, and with the cooperation they are receiving from the South Oil Company (SOC), Shahrستاني said. Shahrستاني believes the BP contract will be signed by the end of September or mid October.

15. (C) Shahrستاني had more details for his plan on the allocation of those fields that were not awarded in the first bid round. He said the "mismatch" between what the IOCs were willing to offer and what the MOO was willing to accept was due to two factors: (1) a lack of clarity over the taxation regime; and (2) "exaggerated" concern over the "security factor." Now that these two factors have, in his view, been further clarified, he plans to again offer the top bidder for each field the opportunity to reduce its fees to the level sought during the bid round by the MOO. (Note: In many cases the discrepancy between the IOC offer and the MOO price was a factor of two or more. End note.) Shahrستاني said he is "not sure if the IOCs can come down with their revised bids to (the level) we offered" but if they do so, the MOO will be "happy to sign" a deal. If no such deal is reached,

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the MOO is prepared to invite the top three bidders to re-compete for the fields, using the same final contract terms as those that will ultimately be offered to BP. Shahrستاني pledged that the results of this re-bid would not disadvantage BP. (Comment: He did not make it clear how he could honor this pledge, if BP must be held to its very low fee while other IOCs could be granted higher fees in a re-bid process. End comment.)

16. (C) Shahrستاني highlighted a key modification to the proposed Rumaila contract that has been arranged as a result of negotiations with BP: the formation of a joint company to administer the field. Previously the contract stipulated that a "field operating division" (FOD) would be formed by the state-run SOC and would manage the field. As the principal investor, BP objected to its lack of control. The new structure eliminates the FOD and replaces it with a joint management structure in which "the investor practically has a veto on (capital expenditure) investment decisions." This same management structure will be offered to all re-bidders for first bid round fields. Shahrستاني expects that the arrangements for second bid round fields will be "easier" because most are green-field projects, rather than well-defined fields already under Iraqi development. (Comment: We hope he intends to use similar logic to justify greater flexibility in the financial terms offered for second bid round fields as well. More attractive financial terms in the second round could allow for a greater success rate and much improved economics for the IOCs, while allowing Shahrستاني to avoid negative comparisons with the unacceptably low fees offered during the first bid round. End comment.)

Hydrocarbons Legislation

17. (C) Shahrستاني noted that draft hydrocarbons sector reform legislation has been stalled in the Council of Representatives (CoR, Iraq's Parliament) for two years, and he is not optimistic about its chances for passage before the January 2010 national elections. However, he pointed to recent progress with the national oil company law (which

passed the Council of Ministers in August) and reiterated his belief that a revenue sharing law would be the easiest of the four bills to pass on its own. He said the GOI is prepared to move forward on such a law by itself, while the KRG is holding out for passage of all four pieces of hydrocarbons legislation as a package. (Comment: KRG officials tell us that they are prepared to move forward with just the revenue sharing law alone. Thamir Ghadban, the GOI Prime Ministerial Advisor, however, is holding out for all four laws, concerned that the KRG would pocket the revenue sharing, abandon efforts on remaining reform legislation, and continue to unilaterally sign oil exploration and production contracts that Baghdad considers illegitimate. End Comment.)

Shahristani said it would be "very good" if the USG could persuade the KRG to consider movement on a stand-alone revenue sharing law. He felt passage of such a law would be "a good signal" and could even provide momentum for passage of the remaining reform laws.

Natural Gas

18. (C) Asked about Iraq's plans for natural gas, Shahristani noted that most current gas production is from natural gas associated with oil production in the south. Much of that gas is currently flared, but the GOI is in discussions with Shell to capture and process that gas for export as LNG. He also alluded to possible uses including electricity generation and developing a domestic petrochemical industry. There is also natural gas potential in the North and West of Iraq, Shahristani noted, but the gas from those projects would be used in domestic electricity generation. The IOCs have shown no interest in participating in a project with Iraqi domestic consumption as its anchor customer, he said, so the GOI plans to develop some gas fields (including the two gas fields not awarded in the first bid round) by itself.

He estimated this process would take "two to three years" and that "most of that gas will be needed locally to supply Iraq's ambitious (electricity) generation program." Shahristani said Syria is very interested in Iraqi gas, but would be supplied with only about 50 MMscf per day of gas (which he characterized as "not much.")

19. (C) After developing the first and second round oil

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fields, Shahristani said, there will be "plenty of gas to export," and Iraq is "very keen" to be a natural gas supplier to Europe. He said that to be seen as a dependable supplier to Europe is politically important for Iraq. It would be difficult to make a commitment now, he said, but "if the current mindset continues" (that is, if Maliki is re-elected), Iraq would likely commit to supply natural gas to Europe, even if that were not the most lucrative export option. Exports would "most likely be a balancing act" between such pipeline exports to Europe and the LNG exports. Shahristani agreed that such a plan could include exports via the Nabucco gas pipeline, but called Prime Minister Maliki's promises to supply 15 Billion cubic meters per year by 2017 "very high." (Note: In prior press statements, Shahristani said that the availability of gas exports to Europe would depend on Iraq's gas demand domestically, but in any case would come no sooner than 2015. End note.)

U.S.-Iraq Investment Conference

10. (U) Shahristani regretted he could not attend the upcoming investment conference in Washington, owing to other pressing duties including the upcoming bid round and the upcoming national elections. In any case, he said, the conference is intended to highlight what opportunities Iraq has to offer investors, and he is confident the IOCs are already well aware of those opportunities in the oil and gas sector. The conference, in his view, would have little new

information to offer the Exxons of the world, but might influence other companies in other sectors to consider Iraq. He said that other senior officials from the Ministry of Oil would attend the conference. (Comment. Post intends to press PM Maliki to send Sharistani to the conference.)

¶11. (U) The delegation cleared this cable.
HILL